BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNI?

In the Matter of the Appeal of)
)
PITTSBURGH-DES MOINES STEEL COMPANY)

For Appellant: John T. Mackin,
Tax Manager

For Respondent: Brian W. Toman
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Pittsburgh-Des Moines Steel Company against proposed assessments of additional franchise tax in the amounts of $7,586.89 and $11,621.10 for the income years 1969 and 1970, respectively.

The issues presented by this appeal are:. (1) whether appellant has established error in respondent's determination that a joint venture in which appellant held a 50 percent ownership interest constituted part of its unitary business operations during the income years in issue; and (2) whether sales of steel structures fabricated outside California and erected within this state were properly included in the numerator of appellant's sales f-actor.

Appellant was incorporated in Pennsylvania in 1916 and began doing business in California in 1947. While appellant's home office is located in Pittsburgh, Pennsylvania, its unitary business is divided into three geographical divisions: Eastern, Central, and Western. The Western Division is headquartered in Santa Clara, California.

Appellant is involved in various aspects of the steel industry. Specifically, it engages in the fabrication and erection of water and fuel tanks, the construction of stainless steel pool liners, reactor supports, structural steel and auxiliary vessels for nuclear power plants, the operation of steel milling plants, and the sale of steel from its warehouses. During the appeal years, appellant was also engaged in two joint ventures, one of which is the focal point of this appeal.

In September of 1968, appellant and a Mr. Fred Sahadi entered into a joint venture agreement which provided that the project (hereinafter referred to as "the Towers") was to be a joint operation between the two parties. The Towers was a real estate project consisting of two office buildings located in Campbell, California. After the completion of construction, it was to lease office space. Neither party was authorized to act as a general agent for the other party, and each was to have equal voice in the Towers' management, although Sahadi was to handle the d'ay-to-day operations for an established fee. Appellant was to design, fabricate, and construct the superstructures for the Towers, as well as to contribute materials and cash to the joint venture; Sahadi was to contribute cash as well as the land upon which the buildings would be constructed. Based upon information supplied by appellant, it appears that appellant's total contribution to the joint venture totaled $1,300,296.00, including $381,794.00 in materials used in the project's construction. The materials contributed by appellant were of the same type it used in

its unitary business, and constituted approximately 16 percent of the total cost of the Towers project. The contribution formula was designed to ensure that each party contributed equally to the project. The profits and losses from the venture were also to be shared equally, and both parties had equal say in approval of the Towers' professional manager, the form of the leases, prospective tenants, use of the leased space, and the employment of personnel and leasing agents.

Appellant filed combined reports for the income years in issue excluding therefrom the income and apportionment factors associated with the Towers. In addition, appellant also excluded from the numerator of its sales factor the sale of certain steel structures which had been fabricated outside California, and which were shipped to, and erected in, this state. Upon audit, however, respondent determined that the Towers constituted a part of appellant's unitary business and that appellant's distributive share of the Towers' income and apportionment factors should be included in its California combined report. In addition, respondent concluded that the sales of the aforementioned steel structures were properly includable in the numerator of appellant's sales factor. Appellant protested, and the denial of its protest led to this appeal. After appellant provided additional information, respondent determined the proposed assessment for 1969 should be reduced to $7,031.23.

The parties to this appeal agree that, under respondent's regulation 25137, subdivision (e), the ownership standards normally applicable in cases of this type need not be satisfied with respect to the inclusion of a joint venture as part of a unitary business. (See Appeal of Saga Corporation, Cal. St. Bd. of Equal., June 29, 1982, wherein we held that the rationale underlying the cited regulation is controlling for all years to which the Uniform Division of Income for Tax Purposes Act (UDITPA) is applicable.) Accordingly, the initial issue presented by this appeal is whether the Towers constituted a part of appellant's unitary business, disregarding the otherwise normally applicable ownership requirements.

When a taxpayer derives income from sources both within and without California, it is required to measure its California franchise tax liability by its net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 25101.) If the

taxpayer is engaged in a unitary business with an affiliated entity,. the amount of income attributable to California sources must be determined by applying an apportionment formula to the total income derived; from the combined unitary operations of the affiliated companies. (See Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947); John Deere Plow Co. v. Franchise Tax Board, 38 Cal.2d 214 [238 P.2d 569] (1951), app. dism., 343 U.S. 939 [96 L.Ed. 1345] (1952).)

The California Supreme Court has determined that a unitary business is definitely established by the existence of: (1) unity of ownership: (2) unity of operation as evidenced by central purchasing, advertising, accounting, and management divisions: and (3) unity of use in a centralized executive force and general system of operations. (Butler Bros. v. McColgan, 17 Cal.2d 664, 678 [111 P.2d 334] (1941), affd., 315 U.S. 501 [86 L.Ed. 9911 (1942).) The court has also held that a business is unitary when the operation of the business within California contributes to or is dependent upon the operation of the business outside the state. (Edison California Stores, Inc. v. McColgan, supra, 30 Cal.2d at 481.) These principles have been reaffirmed in more recent cases. (Superior Oil Co. v. Franchise Tax Board, 60 Cal.2d 406 [34 Cal.Rptr. 545, 386 P.2d 33] (1963); Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal.2d 417 [34 Cal.Rptr. 552, 386 P.2d 40] (1963).) The existence of a unitary business may be established if either the three unities or the contribution or dependency test is satisfied. (Appeal of F. W. Woolworth Co., Cal. St. Bd. of Equal., July 31, 1972.)

In concluding that appellant and the Towers were engaged in a single unitary business, respondent relied exclusively upon the contribution or dependency test which it found satisfied by the following unitary factors: appellant's contribution of the materials used to construct the project's steel superstructures; the contribution of management skills on a major policy decision level; appellant's contribution of know-how to the Towers in the construction of the project: appellant's supplying of labor and supervision during the project's construction; and the Towers' dependence upon appellant for financial support. In previous cases, these, or analogous unitary features, when viewed in the aggregate, have compelled the conclusion that a unitary business existed. (See, e.g., Chase Brass & Copper Co. v. Franchise Tax Board, 10 Cal.App.3d 496 [87 Cal.Rptr.

239], app. dism. and cert. den., 400 U.S. 961 [27 L.Ed. 2d 381] (1970); Appeal of Shachihata, Inc U.S.A., Cal. St. Bd. of Equal., Jan. 9, 1979; Appeal of Beecham, Inc., Cal. St. Bd. of Equal., March 2, 1977; Appeal of I-T-E Circuit Breaker Company, Cal. St. Bd. of Equal., Sept. 23, 1974; Appeals of The Anaconda Company, Cal. St. Bd. of Equal., May 11, 1972.)

Respondent's determination that the Towers constituted part of appellant's unitary business is presumptively correct. (Appeal of John Deere Plow Co. of Moline, Cal. St. Bd. of Equal., Dec. 13, 1961.) The burden to produce sufficient credible evidence to negate the existence or significance of the unitary connections relied upon by respondent and thereby overcome the presumptive correctness of respondent's determination is upon appellant. (See Appeal of Saga Corporation, supra.) Appellant has argued that it is engaged in a different business from that of the Towers; the latter being a real estate project leasing space to business clients as opposed to fabricating and erecting steel structures. The diversity of these businesses, appellant maintains, dictates the conclusion that their operations are nonunitary. The identical contention was directly confronted in our decision in the Appeal of Wynn Oil Company, decided February 6, 1980, wherein we held that the mere fact that two business entities are engaged in diverse lines of business does not, standing alone, preclude a finding that such businesses are unitary.

In addition to the argument noted above, appellant contends that the contribution or dependency test has not been satisfied since the two business entities do not share facilities, personnel, and accounting services, and also because there are no inter-company transactions between appellant and the Towers. Whatever may be the current status of the relationship between appellant and the Towers, appellant's assertion does nothing to refute the contribution and dependency apparent in the operations of appellant and the Towers during the income years in issue. As noted above, the record of this appeal reveals that, during the appeal period, the Towers was heavily dependent upon appellant for financial support and the provision of materials used in the construction of the project, including the steel superstructures, and that appellant contributed supervision and know-how to the Towers' construction as well as participating in major policy decisions. This was unquestionably a relationship requiring unitary treatment and we find, therefore, that appellant's

distributive share of the Towers' income and apportionment factors should be included in the former's combined report.

The second issue presented by this appeal concerns appellant's contention that the sale of certain steel structures fabricated outside California and later shipped to, and erected in this state, constituted the sale of something other than tangible personal property. Respondent determined that the sales of these structures* were sales of tangible personal property and should be included in the'numerator of the sales factor as sales in California pursuant to section 25135 of the Revenue and Taxation Code. Section 25135 provides in pertinent: part that sales of tangible personal property are in this state if "[t]he property is delivered or shipped to a purchaser ... within this state regardless of the f.o.b. point or other conditions of the sale."

Appellant has taken the position that the sales of the subject steel structure& are sales of other than tangible personal property, and, therefore, subject to section 25136, not section 25135. 'Section 25136 provides that sales of other than tangible personal property are in this state if:

> (a) The income-producing activity is performed in this state; or
>
> (b) The income-.producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

Since, according to appellant, the subject sales are sales of other than tangible personal property and a greater proportion of the costs results from activities performed outside California, in accordance with section 25136, none of the sales are attributable to California.

In the Appeal of The Babcock and Wilcox Company, decided by this board on January 11, 1978, we addressed the identical issue in a factual situation quite similar to the instant appeal. In that case we found that, under the relevant case and statutory law, the steam generating systems in issue constituted tangible personal property. The analysis employed in that appeal is equally applicable here, and inevitably leads to the conclusion that the steel structures under

discussion constituted tangible personal property. As has appellant, the taxpayer in Babcock advanced the position that since the greater proportion of the total production costs incurred with respect to the subject property were incurred outside California, the ultimate sale must be of something other than tangible personal property. For the same reasons set forth in the cited appeal, we find appellant's argument untenable. In any event, the fact that the majority of the total production costs incurred with respect to the steel structures were incurred outside California does not alter their classification as tangible personal property. (See, e.g., General Electric Co. v. State Board of Equalization, 111 Cal.App.2d 180 [244 P.2d 427] (1952).)

For the reasons set forth above, respondent's action in this matter will be sustained.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Pittsburgh-Des Moines Steel Company against proposed assessments of additional franchise tax in the amounts of $7,586.89 and $11,621.10 for the income years 1969 and 1970, respectively, be and the same is hereby modified in accordance with respondent's concession that the proposed assessment for the income year 1969 be reduced to $7,031.23. In all other respects, the action of the Franchise Tax Board is sustained:

Done at Sacramento, California, this 21st day of June, 1983, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg and Mr. Nevins present.

William M. Bennett, Chairman

Conway H. Collis, Member

Ernest J. Dronenburg, Jr., Member

Richard Nevins, Member

- - - -, Member